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I. INTRODUCTION

In *United States v. O'Hagan*, the United States Supreme Court accepted misappropriation of information from whatever source as a basis for finding a violation of § 10(b) and Rule 10b-5 of the Securities and Exchange Act of 1934.[1] The misappropriation theory is a way that various courts in the past have imposed liability on people trading securities on the basis of misappropriated information.[2] Historically, only those who could be classified as insiders[3] were held liable under a theory of insider trading for violating § 10(b) and Rule 10b-5. However, because of its broad reading of § 10(b) and Rule 10b-5, the Court accepted the misappropriation theory and extended such liability to all people who misappropriate[4] material, nonpublic information and use that information in an exchange of securities.[5]

The ability to apply the misappropriation theory is an important victory for the government because it creates liability for all people who fraudulently trade securities, regardless of the relationship between the misappropriator and the corporation whose stocks are being traded.[6] Allowing people to trade on the basis of inside information, whether they receive that information through an insider position or through some other means, threatens the honesty and integrity of the securities market.[7] Misappropriators should face liability for their actions. This note ad-

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1. United States v. O'Hagan, 117 S. Ct. 2199 (1997).

2. *See* United States v. Chestman, 947 F.2d 551, 566 (2d Cir. 1991) (en banc); SEC v. Cherif, 933 F.2d 403, 410 (7th Cir. 1991); SEC v. Clark, 915 F.2d 439, 453 (9th Cir. 1990).

3. An insider can be defined as:

> [A] person recognized or accepted as a member of a group, category, or organization: as A: a person who is in a position of power or has access to confidential information B: one (as an officer or director) who is in a position to have special knowledge of the affairs of or to influence the decisions of a company.

MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY, Tenth Ed. 1995.

4. A person need not be an insider in order to be a misappropriator. A misappropriator is one who illegally obtains information.

5. *See O'Hagan*, 117 S. Ct. at 2205.

6. *See* Bruce A. Hiler, *United States v. O'Hagan: The Supreme Court Upholds the Misappropriation Theory of Insider Trading Liability*, INSIGHTS, Sept. 1997, at 2.

7. *See* 15 U.S.C. § 78(b).

dresses the question of whether the Court's broad reading of § 10(b) and Rule 10b-5 is the most appropriate way to legitimize the misappropriation theory and proposes that it is not. Instead of such a broad reading, the Court should have either clarified the boundaries of the theory or completely refrained from approving the theory.

Although the Court has clearly expressed its willingness to use the misappropriation theory to convict those who violate § 10(b) and Rule 10b-5, questions remain as to how the theory should be applied.[8] It is important that both misappropriators and insiders be held liable, but it is equally important to define with reasonable certainty the kind of conduct that gives rise to such liability.[9] Rather than leaving that task to the lower courts, it would be more appropriate to approach the problem in a way that is less likely to perpetuate the uncertainties inherent in the misappropriation theory.

This note addresses the strengths and weaknesses of the Court's analysis in *O'Hagan*. Part II gives a historical background of the events leading up to the *O'Hagan* case and the misappropriation theory. Part III gives the factual background of the case. Part IV explains the Court's reasoning in *O'Hagan*. Part V criticizes the newly approved misappropriation theory and part VI gives several alternatives to interpreting § 10(b) broadly enough to uphold the misappropriation theory.

II. HISTORICAL BACKGROUND

A. Securities Exchange Act of 1934, § 10(b), and Rule 10b-5

In response to the stock market crash of 1929 and the Great Depression that followed, Congress passed the Securities Exchange Act of 1934 (Exchange Act).[10] The primary purpose of the Exchange Act was to promote the stability and confidence of the stock market and to prevent fraud, thereby encouraging investors to invest their money in securities.[11]

One portion of the Exchange Act that was promulgated specifically for the purpose of prohibiting fraudulent exchanges of securities is § 10(b). In pertinent part, this section explains that it shall be unlawful:

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8. *See* Hiler, *supra* note 6.

9. *See* David M. Brodsky & Daniel J. Kramer, *A Critique of the Misappropriation Theory of Insider Trading*, ALI-ABA COURSE OF STUDY, May 16, 1997, at 105, 133-34.

10. *See*, Shawn J. Lindquist, Note, *United States v. O'Hagan: The Eighth Circuit Throws the Second Strike to the Misappropriation Theory of Rule 10b-5 Liability*, 1997 BYU L. REV. 197, 198 (1997).

11. *See* 15 U.S.C. § 78.

> To use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[12]

In an effort to curtail securities exchanges based on information not made available to the trading public, and in accordance with its rule making authority, the Securities and Exchange Commission later adopted Rule 10b-5. This rule makes it:

> [U]nlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, [or] . . . (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, 'in connection with the purchase or sale of any security.'[13]

Together, Rule 10b-5 and § 10(b) have become "the basic federal antifraud provisions used by the SEC."[14]

B. Enforcing the Act

As an antifraud provision, § 10(b) and Rule 10b-5 have been narrowed to a protection against insider trading. Two theories arose from attempting to protect against insider trading, the classical theory of liability and the misappropriation theory. Both of these theories demonstrate ways in which there will be liability for trading securities on information that is not made available to the public.

1. The classical theory of liability for insider trading.

Under the classical theory, a person can be held liable for insider trading "when a corporate insider trades in the securities of his corporation on the basis of material, nonpublic information."[15] The classical theory applies to insiders, defined as "officers, directors, and other permanent insiders of a corporation," as well as "attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation."[16] Because of their relationship with a company, these insiders have infor-

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12. 15 U.S.C. § 78j(b).
13. 17 C.F.R. § 240.10b-5 (1996).
14. Lindquist, *supra* note 10, at 199.
15. United States v. O'Hagan, 117 S. Ct. 2199, 2207 (1997).
16. *Id.*

mation about the company that is not readily available to the public. By allowing an insider to trade securities on the basis of material, nonpublic information, the purpose of the Exchange Act is undermined. Therefore, under this theory, liability would arise if an insider trades without disclosure of their intent to trade securities.

2. *The misappropriation theory of liability for insider trading.*

The misappropriation theory is much broader than the classical theory. Under this theory, liability arises when a person "misappropriates confidential information for securities trading purposes in breach of a duty owed to the source of the information."[17] This theory bases liability "on a fiduciary-turned trader's deception of those who entrusted him with access to confidential information."[18] Here, there is no need to be an insider of the corporation as defined in the classical theory. A fiduciary duty to the provider of information is sufficient to establish § 10(b) and Rule 10b-5 liability.

C. Split Jurisdictions

For many years the Supreme Court declined to rule on the validity of the misappropriation theory.[19] This caused a split in federal jurisdictions as to whether or not the misappropriation theory was a valid basis for a cause of action. Three circuit courts saw the Supreme Court's silence as approval of the theory,[20] while two circuits read this silence as disapproval of the theory.[21]

1. *Jurisdictions in favor of the misappropriation theory.*

The Second Circuit was the first to openly adopt the misappropriation theory by the decision in *United States v. Newman*.[22] Later, sitting *en banc*, the Second Circuit ratified the theory.[23] The Seventh and Ninth Circuits followed the Second Circuit by also ruling the misappropriation theory was an appropriate basis for a cause of action to establish insider trading liability under § 10(b) and Rule 10b-5.[24] Even though the Su-

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17. *Id.*
18. *Id.*
19. *See* Chiarella v. United States, 445 U.S. 222 (1980); Carpenter v. United States, 484 U.S. 19 (1987).
20. *See infra* part II, section C, subsection 1 for specific cases and citations.
21. *See infra* part II, section C, subsection 2 for specific cases and citations.
22. 664 F.2d 12 (2d Cir. 1981).
23. United States v. Chestman, 947 F.2d 551, 566 (2d Cir. 1991) (en banc).
24. *See* S.E.C. v. Cherif, 933 F.2d 403, 410 (7th Cir. 1991); S.E.C. v. Clark, 915 F.2d 439, 453 (9th Cir. 1990).

preme Court had not yet recognized such a theory, these lower courts deemed the misappropriation theory "compatible with the broad language" of § 10(b) and Rule 10b-5.[25]

2. Jurisdictions opposed to the misappropriation theory.

The Fourth Circuit questioned the validity of the misappropriation theory and ruled it was an invalid basis for a cause of action in *United States v. Bryan*.[26] The court in *Bryan* reasoned that the Supreme Court in *Dirks v. S.E.C.*[27] warned against further broadening the language of § 10(b) and Rule 10b-5.[28] In the predecessor to the Supreme Court's decision in *O'Hagan*, the Eighth Circuit also ruled against the misappropriation theory.[29] Similar to the reasoning of the Fourth Circuit, the Eighth Circuit reasoned that the misappropriation theory did not fit within the confines of Supreme Court precedent.[30]

III. FACTUAL BACKGROUND

A. Factual History

The Respondent, James Herman O'Hagan, was a partner in the law firm of Dorsey & Whitney (Dorsey) in Minneapolis, Minnesota.[31] Dorsey was involved in representing Grand Metropolitan PLC (Grand Met) in a potential tender offer for the public stock of Pillsbury Company.[32] Although O'Hagan was not personally involved in representing Grand Met, the jury determined that he misappropriated information from Dorsey regarding the tender offer, and in turn used that information to exchange securities on the basis of nonpublic information.[33] Over a period of approximately two months, O'Hagan purchased stock and call options in Pillsbury stock totaling 7,500 shares.[34] After the announcement of the tender offer, O'Hagan sold his stock and call options which resulted in a profit of more than $4.3 million.[35]

B. Procedural History

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25. *Clark*, 915 F.2d at 453. *See also Cherif*, 933 F.2d at 410.
26. 58 F.3d 933, 943-59 (4th Cir. 1995).
27. 463 U.S. 646 (1983).
28. *Bryan*, 58 F.3d at 943-59.
29. United States v. O'Hagan, 93 F.3d 612 (8th Cir. 1996).
30. *See Id.*
31. *See* United States v. O'Hagan, 117 S. Ct. 2199, 2205 (1997).
32. *See Id.*
33. *See Id.*
34. *See Id.*
35. *See Id.*

O'Hagan was convicted in district court for 57 counts of mail fraud, securities fraud, and money laundering, and he was sentenced to a 41-month term of imprisonment.[36] The convictions were based in part on the misappropriation theory under § 10(b) and Rule 10b-5. The Court of Appeals for the Eighth Circuit reversed all of the convictions, holding that trading securities by using misappropriated information will not incur § 10(b) and Rule 10b-5 liability.[37] It was held that according to the strict reading of the statute, and according to Supreme Court precedent, the misappropriation theory does not fit within the confines of § 10(b) and Rule 10b-5.[38]

IV. REASONING

A. Upholding the Misappropriation Theory

The Supreme Court reversed and remanded the Eighth Circuit's decision, interpreting § 10b and Rule 10b-5 broadly enough to include the misappropriation theory.[39] The Court interpreted § 10(b) and Rule 10b-5 as requiring a two-prong test that would prohibit "(1) using any deceptive device (2) in connection with the purchase or sale of securities, in contravention of rules prescribed by the Commission."[40] By defining the 'in connection with' prong broadly, the Court found that securities traders who misappropriate information fall within these two prohibitions, and therefore the misappropriation theory was upheld.

1. The first requirement: deceptive device

Under the misappropriation theory, the 'deceptive device' requirement is fulfilled because the misappropriator does not disclose the misappropriated information. Nondisclosure is required since "the deception essential to the misappropriation theory involves feigning fidelity to the source of information."[41] It thereby follows that "if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation."[42]

2. The second requirement: in connection with a securities transaction

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36. *See Id.*
37. *See Id.* at 2206.
38. *See Id.*; *See also* United States v. O'Hagan, 92 F.3d 612 (8th Cir. 1996).
39. *See O'Hagan*, 117 S. Ct. at 2206.
40. *Id.*
41. *Id.* at 2209.
42. *Id.*

The 'in connection with' a securities transaction is consummated under the misappropriation theory once a securities exchange occurs. According to the Court, since the only true benefit of the misappropriated information comes from the exchange of securities, this requirement is met once the exchange takes place.[43] If, however, the misappropriated information has "value to the malefactor apart from [its] use in a securities transaction"[44] then the 'in connection with' requirement is not met and there will be no § 10(b) violation.

B. Requirement of Scienter

In response to the many arguments made by certain amici and in response to the dissent's opinion,[45] the majority made it clear that a vital part of the decision rests on "two sturdy safeguards Congress has provided regarding scienter."[46] The first of these safeguards is that "[t]o establish a criminal violation of Rule 10b-5, the Government must prove that a person 'willfully' violated the provision."[47] The second safeguard provided by Congress is that "a defendant may not be imprisoned for violating Rule 10b-5 if he proves that he had no knowledge of the rule."[48] This second safeguard, however, does not apply to fines, and such fines can reach up to $1 million.

V. ANALYSIS

A. A Fuzzy 'In Connection With' Requirement

One of the problems with interpreting § 10(b) and Rule 10b-5 is that both contain very broad language. Because of this broad language, many questions have arisen as various courts try to define the scope of § 10(b) and Rule 10b-5 liability, especially as applied under the misappropriation theory.[49] The Court in *O'Hagan* clarified the 'deceptive device' requirement of the misappropriation theory, but the 'in connection with' requirement is still unclear and the majority seems quite content in leaving the uncertainty in how to apply this second prong.[50]

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43. *See id.*
44. *Id.*
45. *See id.* at 2221-25.
46. *Id.* at 2214.
47. *Id.* (citations omitted).
48. *Id.*
49. Brodsky, *supra* note 9, at 133-34; *see also*, Lindquist, *supra* note 10, at 200.
50. *See* Hiler, *supra* note 6, at 2-5.

1. The 'deceptive device' requirement: a clear definition

Prior to *O'Hagan*, it was somewhat unclear as to § 10(b)'s definition of deception in respect to the misappropriation theory. The Court clarified the issue by explaining that 'deception' in the § 10(b) context is the nondisclosure of an agent's intent to buy or sell securities.[51] Therefore, when a person has a fiduciary duty, or other legal obligation to a principal, that person must disclose any intention to use information gained as a result of the relationship in a securities exchange. "[F]ull disclosure forecloses liability" since the "deception essential to the misappropriation theory involve[s] feigning fidelity to the source of information."[52] This meaning of deception is unambiguous and makes it easy to understand the first prong in the two-prong test. Although some argue that it may not always be clear when disclosure is required,[53] at least it is clear that the deceptive requirement is met when there is nondisclosure.

2. The 'in connection with" requirement: a balancing test

The Court failed to provide adequate guidance for the second prong of the two-part test. Here, instead of drawing a bright line that lower courts can follow, the Supreme Court created a balancing test to determine whether or not something is 'in connection with' a securities transaction.[54] A fuzzy connecting line was drawn between the misappropriation of confidential information and the selling or purchasing of securities to meet the 'in connection with' standard required by § 10(b).[55] The Court said that *ordinarily* misappropriated information that is used in a securities transaction obtains its value through the trade itself, whereas misappropriating money which is then used to purchase securities will not meet the 'in connection with' test because the money has value outside of the securities trade.[56] Therefore, the misappropriation is consummated through the securities transaction. By using terminology such as 'ordinarily,' the Court made it unclear as to what the boundaries of the 'in connection with' requirement are.

Both the dissent and the respondent made forceful arguments that many other things could be done with information besides exchanging

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51. *See O'Hagan*, 117 S. Ct. at 2209.
52. *Id.*
53. *See* Hiler, *supra* note 6, at 2-4.
54. *See O'Hagan*, 117 S. Ct. at 2221 (Thomas, J., concurring in part and dissenting in part).
55. *See id.* at 2226.
56. *See id.* at 2210. ("Substitute 'ordinarily' for 'only,' and the Government is on the mark.").

securities.[57] The majority however, rejected these arguments and described them as inventive, telling, and imaginative.[58] Regardless of the creativity involved in the arguments, the point remains that it is plausible that misappropriated information could have value outside the mere value of the securities transaction.

It could also be argued that, in many cases, the misappropriation of some information is only one step in a series of events leading to a securities transaction. Will a small amount of misappropriated information still be enough to incur insider trading liability under § 10(b) and Rule 10b-5? For example, what if the misappropriator obtains information, but does not rely on that information alone and seeks further advice. After looking at an analyst's interpretation of the situation, and then combining that additional information with the information already misappropriated, will there be sufficient disconnection to remove § 10(b) liability? By refusing to acknowledge such arguments, the majority forced the lower courts to address them. The lower courts then, without sufficient guidance, are responsible to determine whether or not something is closely enough 'in connection with' the transaction to incur liability. This may result in rulings so inconsistent that due process concerns may be raised.[59] For example, if people are not aware that their action constitutes a crime and are arrested, it will be easy to argue that the arrest took place without due process of the law.

The Court reasoned that "[s]hould a misappropriator put such information to other use, the statute's prohibition would not be implicated."[60] Instead of clarifying the 'in connection with' requirement, such a statement confuses the issue. Lower courts are required to apply a balancing test to determine how information has been used. This statement implies that some information can have value outside the realm of trading securities. The Court suggested that any property or information that has "value to the malefactor apart from their use in a securities transaction"[61] should not be subject to the 'in connection with' requirement. But as the dissent argued, "[i]f the relevant test under the 'in connection with' language is whether the fraudulent act is necessarily tied to a securities transaction, then the misappropriation of confidential information used to trade no more violates § 10(b) than does the misappropriation of funds used to trade."[62] Although the majority argued that "[i]t is hardly remarkable that

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57. *See id.* at 2223-24; *See also* Transcript of Oral Argument at 33-34, *O'Hagan*, 117 S. Ct. at 2199.

58. *See* 117 S. Ct. at 2210 n.8.

59. *See id.* at 2220.

60. *Id.* at 2209.

61. *Id.*

62. *Id.* at 2223-24 (Thomas, J., concurring in part and dissenting in part).

a rule suitably applied to the fraudulent uses of certain kinds of information would be stretched beyond reason were it applied to the fraudulent use of money."[63] The same argument can surely be applied to the misappropriation of information. Here, it seems as if the majority made its decision and simply tried to make the meaning fit within its own parameters. A valid argument was recognized, but the majority put the argument aside as trivial and even comical.[64]

In response to the majorities argument, Justice Thomas argued that:

> Once the Government's construction of the misappropriation theory is accurately described and accepted—along with its implied construction of § 10(b)'s 'in connection with' language—that theory should no longer cover cases . . . involving fraud on the source of information where the source has no connection with the other participant in a securities transaction. It seems obvious that the undisclosed misappropriation of confidential information is not necessarily consummated by a securities transaction.[65]

This argument, regardless of how obvious to the dissent, was not so obvious to the majority.

The majority's decision is bound to cause extensive problems in the lower courts. "The absence of a coherent and consistent misappropriation theory and, by necessary implication, a coherent and consistent application of the statutory 'use or employ, in connection with' language, is particularly problematic."[66] The type of balancing test created in this case will truly be problematic in the extensive litigation that is sure to come from the majority's decision.

B. Problems with Balancing Tests

Although balancing tests can be helpful in certain situations, there are some instances, such as this one, where a balancing test should be more clearly defined or not used at all. When the Supreme Court makes decisions that are ambiguous, they are essentially guaranteeing the opportunity to revisit the issue. There may be some instances, such as when an issue is not fully ripe, where the Court purposely leaves an issue untouched. This is wise in certain instances. However, there are other instances where serious problems can result from the ambiguities of a balancing test.

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63. *Id.* at 2209-10.
64. *See id.* at 2210 n.8.
65. *Id.* at 2223 (Thomas, J., concurring in part and dissenting in part).
66. *Id.* at 2226 (Thomas, J., concurring in part and dissenting in part).

1. Some significant problems with previous balancing tests

One of the strongest arguments against creating a balancing test is that "it does not provide a useful standard for discovery."[67] Although in reaching their decision, the majority relied on the safeguards created by Congress, they failed to recognize that those safeguards will vary from case to case. An example mentioned by Professor Benjamin Lindquist, an opponent of balancing tests, is illustrative of the point. As an attorney attempts to counsel a client on whether or not she will be held liable under a balancing test such as the 'in connection with' test, the attorney, "is given no concrete assistance from the balancing test. He must first litigate the issue because the balancing test approaches each situation individually and provides different solutions for the cases depending upon the circumstances involved."[68] As a result, the test fails one of the most important underlying principles of establishing a rule which is that it does not present attorneys with clear and practical guidelines.[69]

If an attorney is to effectively counsel a client, she must have a good idea of how a case will most likely play out. Not just lawyers and clients, but all concerned parties should know with reasonable certainty what type of behavior is legal and what is not.

A second problem with balancing tests is that they are judicially inefficient. "As the test consists of a case-by-case analysis, the issue must be litigated every time it arises. The balancing test runs contrary to the trend of decreasing courtroom traffic and legal expenses."[70] Although it may be argued that allowing each person to litigate her own case can be in the best interest of each potential § 10(b) or Rule 10b-5 violator, it is not in the best interest of the system as a whole. There are certain situations where "the vagueness and inadequacy of the test outweigh the benefits it creates."[71] Such is the case with the 'in connection with test.'

2. Examples of previously inefficient balancing tests that require revisiting

There are many examples throughout the Court's history where a balancing test was created and later proved to be so inefficient that it had to be revisited and changed. Although no example is completely analogous to the 'in connection with' balancing test, examples are helpful in show-

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67. Benjamin Lloyd Lindquist, Note, *Ethical Considerations in Model Rule 4.2's Application to the Corporate Litigant*, 20 J. LEGAL PROF. 267, 282 (1996).

68. *Id.*

69. *See Id.*

70. *Id.*

71. *Id.*

ing some of the general inadequacies of balancing tests. One such example can be seen in the way the Court has treated a state's interference in an individual's right to exercise religion. At one point, "the Supreme Court established a balancing test to weigh the competing interests of an individual's right to exercise religion freely and a state's need to restrict that right."[72] Although this balancing test seemed to be an appropriate decision at the time it was made, the issue had to be revisited.[73] Ultimately, "[i]n an attempt to maximize the protection of religious freedom, the Supreme Court replaced the balancing test with the least restrictive alternative test."[74]

Another example of a balancing test that proved inefficient was the Court's attempt to protect an individual's Fourth Amendment right against unlawful searches and seizures. A great deal of criticism has been made in regards to this balancing test, and it is likely to be revisited in the future. One author speaks about the inadequacy of the Court's balancing test process, focusing on *Vernonia School District 47J v. Acton*,[75] which is arguably "the most recent, and most alarming, example of the inadequacy of the Court's balancing test."[76] Here, Professor Buffaloe argues that when there is a loosely defined rule created by the Court (such as the 'in connection with' prong in *O'Hagan*) "the balancing test triggered by the language is so malleable and unprincipled it fails to adequately safeguard" a defendant's rights.[77]

An additional example is cited by Professor Charles who aptly speaks of the problems of a balancing test for issues arising under the Fourth Amendment.[78] He argues that balancing tests favor the government because balancing tests for Constitutional questions allow the government to circumvent the traditional standards that the Founders meant to be applied.[79] The author also gives a fairly comprehensive list of additional arguments that have been given against the Fourth Amendment balancing test.[80] The same is true of the 'in connection with' balancing test. By creat

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72. James J. Lawless, Jr., *Roy v. Cohen: Social Security Numbers and the Free Exercise Clause*, 36 AM. U.L. REV. 217, 223 (1986).

73. *See id.* at 224, 244; *See also* Heffron v. International Soc'y for Krishna Consciousness, 452 U.S. 640, 654-56 (1981).

74. *Id.* at 224.

75. 115 S. Ct. 2386 (1995).

76. Jennifer Y. Buffaloe, Note, *'Special Needs' and the Fourth Amendment: An Exception Poised to Swallow the Warrant Preference Rule*, 32 Harv. C.R.-C.L. L. Rev. 529, 532 (1997).

77. *Id.* at 551.

78. Gut-Uriel E. Charles, *Fourth Amendment Accommodations: (Un)compelling Public Needs, Balancing Acts, and the Fiction of Consent*, 2 MICH. J. RACE & L. 461, 512.

79. *See id.*

80. *See id.* at 512 n.152 (For criticism of the balancing test see *Skinner v. Railway Labor Executives' Ass'n*, 489 U.S. 602, 635, 639 (1989) (Marshall, J., dissenting) (noting that "[p]recisely because the need for action against the drug scourge is manifest, the need for vigilance against

ing a balancing test for the 'in connection with' requirement, the Court has provided a way for lower courts to even further broaden the meaning of the statute, which will allow courts to randomly rule against individuals pursuant to the court's interest and not according to established law.

3. Applying the balancing test concerns to the 'in connection with' test

As shown in the previous examples, the creation of a balancing test for the 'in connection with requirement,' created the risk that lower courts may interpret the rule in different ways.[81] Balancing tests generate more litigation because of the uncertainty of the outcome of such litigation. Such uncertainty in a criminal setting raises due process concerns.[82]

Another problem with the 'in connection with' test is that in some respects this ruling counters the purpose of the Securities and Exchange Act of 1934. The purpose of that act is to establish honesty and integrity in the securities market and promote confidence in the market participants.[83] Although Congress provided safeguards,[84] there are still some serious questions as to who may be liable under the 'in connection with' test. Because of this uncertainty as to liability, confidence in the market may deteriorate to a certain degree. The more one anticipates a possibility of criminal liability for her actions, the less likely one will be to participate in the market. Even though holding misappropriators liable will allow some to have more confidence in the market, other less sophisticated participants may not be so confident for fear of being suddenly and perhaps unknowingly characterized as an insider.[85]

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unconstitutional excess is great," and commenting on the malleability of a balancing search); see also T. Alexander Aleinikoff, *Constitutional Law in the Age of Balancing*, 96 YALE L.J. 943, 944 (1987) (arguing that "complacency blinds us to serious problems in the mechanics of balancing"); Kamisar, *supra* note 6, at 33 (noting that it is not surprising that the government interests prevail when the balancing test is used. "This is usually the result when the Court utilizes what dissenters aptly called 'a formless and unguided "reasonableness" balancing inquiry.' "); Nadine Strossen, *The Fourth Amendment in the Balance: Accurately Setting the Scales Through the Least Intrusive Alternative Analysis*, 63 N.Y.U. L. REV. 1173, 1188-89 (1988) (maintaining that use of the balancing test contributes to the erosion of Fourth Amendment rights); Sundby, *supra* note 61, at 400 (arguing that the balancing test favors government intrusion)).

81. *See* United States v. O'Hagan, 117 S. Ct. 2199, 2226 (1997) (Thomas, J., concurring in part and dissenting in part).

82. *See* Respondents Brief at 30, *O'Hagan*.

83. *See* 15 U.S.C. § 78(b).

84. *See O'Hagan*, 117 S. Ct. at 2214.

85. This Note does not address the requirement of scienter, which in short is the knowledge that a crime is being committed, but suffice it to say that juries are unpredictable and even though there is a stricter requirement before imprisonment will be mandated, the requirement is not so strict for financial penalties.

VI. OTHER OPTIONS

The Supreme Court has created some difficult questions through the *O'Hagan* decision, but the purpose of this note is not to condone misappropriators of information. Holding misappropriators liable for their actions is an important requirement if the securities market is to function efficiently.[86] The Court, however, had better alternatives than the balancing test in *O'Hagan*.

A. *Remove the Ambiguity From the 'In Connection With' Test*

Perhaps the simplest thing to do would have been to remove the ambiguity from the 'in connection with' test. This could be done by eliminating the requirement of interpreting the value of information outside the realm of the securities exchange.[87] If lower courts could decide a case without determining whether the misappropriated information had "value to the malefactor apart from [its] use in a securities transaction," then it would be easier to establish guilt or innocence.[88] The status quo requires courts to determine whether the misappropriation is "sufficiently detached from a subsequent securities transaction" before establishing liability.[89] Misappropriators should know that if they obtain material, nonpublic information then they should either disclose that information or refrain from trading until the information becomes public.

B. *Let Congress Make the Bright-line Test*

One option discussed in Respondent's Brief as well as the Amici Briefs is to allow Congress to codify the misappropriation theory.[90] Since Congress originally created the statute, the Court could "allow Congress to change the statutory prohibition if it so desires."[91] The one problem with this idea is that Congress has had the chance to codify the misappropriation theory and has refused to do so.[92] As the amici for Respondent argue, "the full record of Congress' consideration of the misappropriation theory . . . demonstrat[es] that Congress in fact declined to amend the 1934 Act to criminalize trading on misappropriated information, and that it did so at the S.E.C.'s urging."[93]

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86. *See supra*, part I.
87. *See O'Hagan*, 117 S. Ct. at 2209.
88. *Id.*
89. *Id.*
90. *See* Respondant's Brief, *O'Hagan*; *see also* Amici Briefs for Respondent, *O'Hagan*.
91. Brief of Amici Curiae Law Professors and Counsel in Support of Respondent at 4, *O'Hagan*.
92. *See id.* at 10, *O'Hagan*.
93. *Id.* at 14, *O'Hagan*.

Since the Court has developed the misappropriation theory through case law, Congress now has no need to fill in the gap left by the broad language of § 10(b). The Court seems to be sending a message to Congress that if the statutory language is broad enough, then the courts will take care of the rest on a case-by-case basis. This is in contradiction to a great deal of judicial opinion that has petitioned Congress to be specific in statutory language.[94] By ruling against the misappropriation theory, the Court would have been telling Congress that it needs to fill its own gaps instead of leaving it up to the courts.

C. *Establish Liability under Different Statutes*

Another possibility the Court had was to simply let liability be established through other statutes. For example, state fiduciary duty laws are generally adequate to impose liability for the types of acts being described by the misappropriation theory. The majority even recognized this possibility in a footnote but failed to see that such laws are sufficient to deter misappropriators until Congress codifies the misappropriation theory. The majority said, "once a disloyal agent discloses his imminent breach of duty, his principal may seek appropriate equitable relief under state law."[95] Misappropriating information would generally be enough to show a breach of a fiduciary duty since the agent would not be acting in the interest of the principal. This would allow the principal to recover any damages suffered from the breach. The courts could also impose punitive damages to further deter would-be misappropriators. Since there may be instances where damages may not be fully recoverable, the Rule 10b-5 threat of imprisonment is more appealing to the courts. But breach-of-duty laws should ordinarily cover any damages incurred by the principal.

The greatest amount of injury coming from misappropriated information used in a securities transaction will generally be in the form of damages to the person or entity to whom there is owed a fiduciary duty. Justice demands that the person causing such harm should pay for the damages, and that the person damaged should be compensated. Establishing liability under breach-of-duty laws will make misappropriators pay for the harm they cause to the person who is harmed.

Although this type of liability would not impose criminal sanctions for the damages, it will nevertheless deter illegal activity that takes place through the trading of securities based on misappropriated information. Additionally, if the courts refuse to interpret statutes in the broadest way

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94. *See* Williams v. United States, 458 U.S. 279, 290 (1982); *See also* Dunn v. Commodity Futures Trading Comm'n, 117 S. Ct. 913, 921 (1997).

95. *O'Hagan* 117 S. Ct. at 2211 n.9.

possible, then it is more likely that Congress will write statutes more clearly. Even if criminal liability is not available under a breach of some type of fiduciary relationship, Congress will have an incentive to create criminal liability for missappropriators instead of relying on the courts to create the liability because of an ambiguous statute. Furthermore, many states have laws that impose criminal liability for fraud or deceit. If lower courts are required to impose liability for the misappropriation of information, they should at least be able to do so based on a statute and not on a rule in the form of a balancing test which is judicially legislated.

VII. CONCLUSION

A. The Court's Decision Helped Establish Some Boundaries

Although the Supreme Court's decision is helpful in some respects, it caused greater confusion in other respects. It is now clear that the misappropriation theory is to be considered a valid theory to create insider trading liability under § 10(b) and Rule 10b-5 and certain boundaries have been created that help courts as well as perpetrators understand when someone should be held liable. These boundaries are helpful and can be of great importance in establishing guidelines for lower courts to use when applying the misappropriation theory. But some boundaries are still lacking.

B. The Remaining Boundaries Need to be Clearly Defined

One flaw of this decision is that it is unclear how the second step of the two-prong test should be applied. A balancing test has been created which will be difficult to follow in the future. This problem could be solved in various ways, including the intervention of Congress and establishing different types of liability instead of just § 10(b) and Rule 10b-5 liability. This would allow investors to be liable for damages caused, but would not impose criminal liability from an uncertain, ambiguous, and judicially legislated balancing test.

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